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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 61

ETHEL MEYER, PETITIONER

v.

UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (R. 19-20) is reported at 202 F. Supp. 606. The opinion of the court of appeals (R. 25-26) is reported at 309 F. 2d 131.

JURISDICTION

The judgment of the court of appeals was entered on October 24, 1962 (R. 27). The petition for a writ of certiorari was filed on January 18, 1963, and was granted on March 4, 1963 (R. 28; 372 U.S. 934).

The jurisdiction of this Court rests upon 28 U.S.C. 1254.

QUESTION PRESENTED

Whether, where life insurance policies have been assigned as collateral security for a bank loan, federal tax liens on their cash surrender values, arising from an assessment subsequent to the assignment, can be satisfied out of the proceeds of the policies that remained after the loan had been paid.

STATUTES INVOLVED

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.):

> SEC. 3670. PROPERTY SUBJECT TO LIEN.
>
> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.
>
> SEC. 3671. PERIOD OF LIEN.
>
> Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

Internal Revenue Code of 1954 (26 U.S.C. 1958 ed.):

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

* * * * *

SEC. 7403. ACTION TO ENFORCE LIEN OR TO SUBJECT PROPERTY TO PAYMENT OF TAX.

(a) *Filing.*—In any case where there has been a refusal or neglect to pay any tax, or to discharge any liability in respect thereof, whether or not levy has been made, the Attorney General or his delegate, at the request of the Secretary or his delegate, may direct a civil action to be filed in a district court of the United States to enforce the lien of the United States under this title with respect to such tax or liability or to subject any property, of whatever nature, of the delinquent, or in which he has any right, title, or interest, to the payment of such tax or liability.

* * * *

STATEMENT

Peter Meyer, petitioner's husband, owned four life insurance policies which named his wife as beneficiary. Their face amounts totaled $50,000 and their cash surrender values at his death totaled $27,285.87. Under the terms of the policies he retained the right

to change the beneficiary, demand the cash surrender value and assign the policies (R. 14-15, 19).

In 1943, prior to the tax assessments in suit, Mr. Meyer assigned the policies as collateral security for a loan from the Huntington National Bank of Columbus, Ohio. Under the terms of the assignment, if Mr. Meyer died with the loan outstanding, the bank was given the right to satisfy its claim out of the "net proceeds of the policy when it becomes a claim by death" (R. 10, 14, 15, 19).

On May 22, 1946, the Commissioner of Internal Revenue assessed a deficiency of $5,633.25 against Mr. Meyer for the year 1945. Notice and demand were made upon him on June 6, 1946. He paid $1,408.18 on April 1, 1946, and $1,408.08 on August 1, 1946, leaving a balance of $2,816.99, plus interest, remaining unpaid (R. 13-14).

On June 17 1947, the Commissioner assessed a deficiency of $3,342.10 against Mr. Meyer for the year 1946. Notice and demand were made upon him on June 18, 1947. No part of this assessment has been paid. As a result of these assessments $6,159.09, plus interest, remains due and owing.[1] A notice of lien was filed in July, 1955. (R. 14).

Mr. Meyer died on December 28, 1955. Petitioner was named executrix of his estate (R. 14, 19). Upon his death, the insurance companies paid $50,664.27, distributing to the bank $26,844.66 to satisfy the

[1] Petitioner has tendered $441.21, the difference between the cash surrender value of the policies at death and the amount then due the bank on the outstanding loan (see R. 9).

outstanding loan and the remainder to petitioner (R. 16, 18, 19).

In September, 1958, the United States commenced suit against the petitioner individually and as executrix of her husband's estate for $6,159.09, the amount of Mr. Meyer's unpaid 1945 and 1946 income taxes plus interest (R. 3-8). The district court granted the government's motion for summary judgment and held that the United States could satisfy its tax lien out of the proceeds in Mrs. Meyer's hands (R. 19-20). The court of appeals affirmed (R. 25-26). Following its earlier decision in *United States* v. *Behrens*, 230 F. 2d 504, certiorari denied, 351 U.S. 919, the court held (R. 26):

> In the present case by reason of the prior pledge of the policies to the bank the government's tax lien was secondary, but it was not nugatory, and the proceeds passed to appellant subject to both claims at the taxpayer's death. Whatever the value of the tax lien during the taxpayer's lifetime, it could be fully satisfied out of that portion of the proceeds representing the former cash surrender value by marshalling the bank's prior claim against the balance of the proceeds at his death.

SUMMARY OF ARGUMENT

In light of this Court's recent decisions, the present case presents only the narrow question whether federal tax liens which might attach to the cash surrender values of life insurance policies are defeated by a prior assignment of the policies to secure a bank loan and a preferred payment of that loan on the

death of the taxpayer which nearly exhausts the cash surrender values. Petitioner's argument is that, because of the senior pledge, the tax liens never attached, and that, in any event, the payment of the bank loan consumed the debtor's property, leaving only the excess death benefits which are immune from the government's lien. In answer, we show, first, that the tax liens, although junior, did attach to the cash surrender values of the policies during the life of the taxpayer. Further, we argue that the bank loan must be deemed to have been paid out of the excess insurance proceeds accruing at death, permitting the federal liens to be satisfied out of the cash surrender fund in the hands of the beneficiary. This result is compelled by the equitable doctrine of marshalling, which is fully applicable in this case and requires the debtor's assets to be so allocated that the two-fund creditor takes from the assets which are not available to the one-fund creditor, so that both may be satisfied.

ARGUMENT

THE FEDERAL TAX LIEN COULD BE SATISFIED OUT OF THE LIFE INSURANCE PROCEEDS IN THE HANDS OF THE TAXPAYER'S BENEFICIARY

This Court's decisions in *Commissioner* v. *Stern*, 357 U.S. 39, and *United States* v. *Bess*, 357 U.S. 51, confine this case within very narrow compass. Under the present facts, the government cannot claim against Mrs. Meyer as the "transferee" of the taxpayer, nor can the tax deficiency be asserted against any portion of the insurance proceeds except that part

which represents the cash surrender value. On the other hand, petitioner must concede (as she apparently does) that the cash surrender value of the policies was "property" of the taxpayer to which the federal tax lien could attach during his lifetime, and that the lien (if it once attached) survives with respect to that value even after the taxpayer has died and the insurance proceeds have been paid over to the beneficiary.[2] The only question open here is whether the prior pledge of the insurance policies to secure a bank loan which nearly exhausts the cash surrender value somehow defeats the federal tax lien.

That issue was first presented and decided on similar facts in *United States* v. *Behrens*, 230 F. 2d 504 (C.A. 2), certiorari denied, 351 U.S. 919. There, as here, the taxpayer died leaving unpaid federal taxes secured by a lien on the cash surrender value of his insurance policies and a bank loan secured by a prior pledge of the policies. The taxpayer had named his wife as beneficiary of the policies, but had retained the right to change the beneficiary, to borrow upon the policies and to collect the cash surrender value from the insurer. 230 F. 2d at 505. There, as here, after the insured's death the bank had a right to satisfy its claim out of the proceeds of the policies. When the insured died, the beneficiary dis-

[2] The New York Insurance Law cited by petitioner (Br. 2-4) cannot affect the attachment of the tax lien during the life of the taxpayer, or its survival in the hands of the beneficiary, as it applies to the cash surrender value of the policies. *United States* v. *Bess*, (*supra*, at 59); *Fink* v. *O'Neil*, 106 U.S. 272.

charged the pledge by paying the bank and received the entire proceeds from the insurer. The government contended that the balance in the hands of the beneficiary included the cash surrender value to which the federal tax lien had attached before the beneficiary's rights had vested. The beneficiary argued that she was entitled to deduct the amount of the prior bank loan from the cash surrender value. This claim was rejected, Judge Learned Hand writing for the court (*id.* at 507):

> The defendant also claims that in any event she was entitled to deduct the amount of the loan that Behrens had obtained from the bank, secured by a pledge of the policies. After his death she paid the loan and now seeks to be subrogated to the pledge. The tax lien, not being filed, did not indeed have priority over the pledge; but the "proceeds" were large enough to pay both claims, and it is well settled law that, when one creditor has a claim against two funds as security and another creditor has a claim against only one of them, the loan of the first will be marshalled against that fund which is security for his loan only.

The *Behrens* rule was followed by the District Court for the Northern District of Ohio in *United States* v. *Wintner*, 200 F. Supp. 157. Its decision was affirmed *per curiam* upon authority of *Behrens* by the Sixth Circuit Court of Appeals, 312 F. 2d 749, and is now pending before this Court on petition for certiorari (No. 98, this Term).[3]

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[3] A few years before the *Behrens* decision, the Fifth Circuit in *United States* v. *Gilmore*, 222 F. 2d 167, certiorari

Petitioner apparently accepts the *Behrens* decision. But she argues that the present case is not governed by it because (1) here (unlike *Behrens*) the tax *assessments* followed a bank pledge that consumed the whole of the taxpayer's property interest in his insurance policies (except $441.21), so that nothing remained to which the tax lien could attach, and (2), in any event, payment of the indebtedness to the bank, made directly by the insurers in this case (unlike *Behrens*), exhausted the cash surrender value of the policies (the only portion of the proceeds to which the tax lien could attach), with the consequence that petitioner never received any part of the liened property (except $441.21). Plainly, neither distinction is valid.

A. THE FEDERAL TAX LIEN ATTACHED TO THE CASH SURRENDER VALUE OF THE POLICIES DURING THE TAXPAYER'S LIFETIME, DESPITE A PRIOR PLEDGE OF THE POLICIES

The argument that after the policies had been pledged the taxpayer retained no interest to which the tax lien could attach is frivolous. For all practical purposes, the situation here is the same as in *Behrens*. While the tax assessments there antedated the bank pledge, the court assumed the resulting lien

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denied, 350 U.S. 843, held that insurance proceeds payable to the wife as beneficiary which were includible in the taxable estate should bear the estate tax attributable to their inclusion to make other assets of the estate available for payment of the income tax debt of the deceased insured. The effect of the decision was to hold that the United States, as a secured creditor for income taxes, came ahead of the wife's beneficial interest in the insurance.

could take effect only upon filing, which, as here, occurred after the pledge. Accordingly, in both cases, the tax lien was junior to the bank's claim, but in neither was the portion of the cash surrender value of the policies already liened exempted from the government's secondary lien. The principle is elementary that the same property is susceptible of bearing multiple liens which, in the aggregate, far exceed the value of the object. The law of security priority and ranking is founded on that premise. One lien may prime another, because it outranks the other, or because, being of equal rank, it is first in time. But the senior lien does not *destroy* the junior. Nor does it deprive the owner of his property interest, which, subject to satisfaction of prior liens, remains available to his creditors.[4] The obvious reason is that the superior lien, though originally so great as to exhaust the value of the property to which it attaches, may be satisfied by payment of the underlying debt, and the junior lien will become of value. As one would expect, the rule applies equally to the government as a junior lienor. See, *e.g.*, *United States* v. *Buffalo Savings Bank*, 371 U.S. 228; *United States* v. *Brosnan*, 363 U.S. 237, 241.

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[4] The pledge of the policies as collateral security did not divest the insured of his general property in them. *In the Matter of O'Meara*, 193 Misc. 790, 792-793, 81 N.Y.S. 2d 388, 390; *Katz* v. *Ohio Natl. Bank*, 127 Ohio 531, 533, 191 N.E. 782, 784; 2 Appleman, *Insurance Law and Practice* (1941), Sec. 1311.

B. THE FEDERAL TAX LIEN COULD BE SATISFIED OUT OF THE REMAINING INSURANCE PROCEEDS PAID TO THE BENEFICIARY, DESPITE A PRIOR PAYMENT TO THE PLEDGEE IN AN AMOUNT SUFFICIENT TO EXHAUST THE CASH SURRENDER VALUE OF THE POLICIES.

Plainly, the federal tax lien attached to the cash surrender value of the policies during the taxpayer's lifetime, despite the prior bank pledge. The remaining question, then, is whether the payment of the pledge consumed the property to which the government's lien attached, leaving only $441.21 out of which to satisfy the tax debt. Judge Hand's opinion in *Behrens*, it seems to us, settles that question. The ruling there was that the beneficiary could not defeat the federal lien by retaining the portion of the insurance proceeds exempt from the tax lien but available to the bank to pay the prior bank pledge. Is the situation different here because the insurer paid the bank directly, leaving the beneficiary no option? We think not. In the first place, nothing indicates that the portion of the proceeds paid by the company to the bank was the part representing the cash surrender of the policies.[5] From the insurer's point of view, there existed only one fund, *all* of which was incumbered by the pledge.[5] It paid the bank the

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[5] The government alleged (R. 15) and the district court expressly found (R. 19) that "the bank was given the right to satisfy its claim out of the net proceeds of the policy when it became a claim by death," and petitioner has never disputed the fact (see R. 16, 18-19). Section 166 of the Insurance Law of New York does not affect the right of a *conventional assignee* to collect the portion of the proceeds not attributable to the cash surrender value of the policy; it merely limits the right of "creditors" to attach the proceeds

amount of the outstanding debt, without purporting to say whether the sum involved should be attributed to cash value or death benefit. But, were it otherwise, it seems plain the insurer could no more defeat the federal lien by a fictitious allocation than could the beneficiary. See, Lawrence, *Equity Jurisprudence* (1929), Sec. 806; *Sehon-Stevenson & Co.* v. *Union Trust Co.*, 113 F. 2d 968 (C.A. 4). The critical fact is that the bank's lien attached to both funds—the cash surrender value fund and the death benefit fund—while the tax lien attached only to the first. Under those circumstances, the controlling principle is that allocation must be made in such a way as to satisfy (so far as possible) both creditors: there can be no juggling to defeat the creditor whose claim is restricted to a single fund.*

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in satisfaction of their claims against the assured. See Petitioner's Brief, pp. 2-4.

See *Katz* v. *Ohio Natl. Bank*, 127 Ohio at 533, 191 N.E. 784; Schwarzschild, *Rights of Creditors in Life Insurance Policies* (1963), p. 114; *The Assignment of Life Insurance as Collateral Security*, 58 Yale L. J. 743, note 5 (1949); and see Revised Comments on Form No. 10—Assignment of Life Insurance Policy as Collateral (Bank Management Commission, American Bankers Association) (1949), p. 16.

* See *Lanoy* v. *Athol*, 2 Atk. 444, 446; *Aldrich* v. *Cooper*, 8 Ves. Jr. 382, 384-385; *Cheesbrough* v. *Millard*, 1 Johns. Ch. (N.Y.) 409, 412; III Blackstone's *Commentaries*, p. 426, note 6th; Maitland, *Equity, Lecture XVII, Administration of Assets (II)* (Brunyate Rev., 1936), p. 266; 2 Story's *Equity Jurisprudence* (14th ed., 1918), Secs. 758, 760, 853-871; 2 Pomeroy's *Equity Jurisprudence* (5th ed., 1941), Secs. 396, 410; 4 Pomeroy's *Equity Jurisprudence* (5th ed., 1941), Sec. 1414; 2 Lawrence, *Equity Jurisprudence* (1929), Secs. 803-824; Keeton, *An Introduction to Equity* (4th ed., 1956), pp.

It is no argument against marshalling that it enables the government to secure indirectly the benefit of the excess proceeds realized upon the death of the delinquent taxpayer, not otherwise directly available to it. Marshalling, by its very nature, always gives the one-fund creditor the indirect benefit of the second fund directly enjoyed by the senior lienor alone. See Langdell, *A Brief Survey of Equity Jurisdiction* (2d ed., 1908), pp. 15-16. The application of marshalling to the double-liened insurance proceeds does not enlarge the government's right, but rather limits the beneficiary—as equity requires—to the unincumbered interest.

In the end, we return to the logic of the *Behrens* rule. The crucial question, between the government and the beneficiary, is by what right the latter can compel the bank to satisfy its loan out of the cash surrender value rather than the excess proceeds. She cannot do so in her own right, since her interest was wholly contingent at the time the tax lien arose and did not vest until the taxpayer's death. It is at this point that the *amicus*' objection (pp. 6-8) to the application of the principle underlying marshalling founders. This is not a case in which creditors are competing with a debtor whose property is protected by public policy. Rather, it is a case in which an unsecured claimant is competing with two secured claimants with respect to property over which their debtor had complete control. See *Chase Nat. Bank*

33, 41, 133-136; Sheldon, *Subrogation* (2d ed., 1893), Secs. 61-70; and see *Sir William Harbert's Case*, 3 Coke 11, 12b, 14b.

v. *United States*, 278 U.S. 327. The only way in which the beneficiary can assert a superior right to the cash surrender value is on the theory advanced by the beneficiary in *Behrens*, *i.e.*, that, having paid the bank loan, she is entitled to be subrogated to the bank's superior right to the cash surrender value. But, as between the United States and the bank, the rule of marshalling is plainly applicable.[7] The result merely reflects the fact that petitioner's interest, derived from the common debtor, is subordinate to the payment of his debts secured by prior liens against the insurance proceeds.

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[7] This Court has considered the marshalling rule in several other instances: *Fenwick* v. *Chapman*, 9 Pet. 461, 474; *Savings Bank* v. *Creswell*, 100 U.S. 630, 641; *Scruggs* v. *Memphis & Charleston R. R. Co.*, 108 U.S. 368, 378; *Merrill* v. *National Bank of Jacksonville*, 173 U.S. 131, 138; *Sowell* v. *Federal Reserve Bank*, 268 U.S. 449, 456-457; see *Lidderdale* v. *Robinson*, 12 Wheat. 594, 596.

It may be noted that where the collection of taxes is not prejudiced, a federal tax debt has been held to be subject to marshalling. Thus, a creditor having a lien on only one asset may compel the United States to exhaust other immediately available assets to which the tax lien applies. *First Nat. Bank of Boston* v. *Proctor*, 40 F. 2d 841 (C.A. 1); *In re Ann Arbor Brewing Co.*, 110 F. Supp. 111 (E.D. Mich.); *United States* v. *Lord*, 155 F. Supp. 105 (D. N.H.). Here, if there were other assets in the debtor's estate, the insurance beneficiary could, as against distributees and general creditors of the estate, be subrogated to the claims of creditors of the estate, or the United States, having liens on the insurance. See *Barbin* v. *Moore*, 85 N.H. 362, 366, 159 A. 409, 83 A.L.R. 62.

CONCLUSION

The judgment below is correct. It should be affirmed.

Respectfully submitted,

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